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No. 06-944

In The
Supreme Court of the United States

AT&T CORP. and
GEORGESON SHAREHOLDER
COMMUNICATIONS, INC.,

Petitioners,

v.

LILA T. GAVIN, On Behalf Of Herself
And All Other Persons Similarly Situated,

Respondent.

**On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Seventh Circuit**

MOTION FOR LEAVE TO FILE AND BRIEF *AMICI CURIAE* OF PETER J. WALLISON IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI OF AT&T CORP. AND GEORGESON SHAREHOLDER COMMUNICATIONS INC.

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MOTION FOR LEAVE TO FILE *AMICI CURIAE* BRIEF

Amici Curiae, Peter J. Wallison, Senior Fellow at the American Enterprise Institute, by and through his counsel of record, Russell G. Petti, hereby moves this Honorable Court for an order permitting this party to file a Brief *Amici Curiae* in support of the Petition for Certiorari.

Mr. Wallison was General Counsel of the U.S. Treasury Department from 1981 until 1985. He has since studied and written extensively about American financial markets, Congressional attempts to encourage uniform and consistent regulation of those markets, and the damage to the markets caused by, inter alia, excessive or uncertain litigation.

Mr. Wallison believes that the Seventh Circuit's decision will have a profound adverse impact on this country's securities markets. The attached *amicus* brief points out certain negative trends affecting the market and explains how Congress has attempted to alleviate the root causes of those negative trends. The brief indicates how the Seventh Circuit's decision will not only exacerbate those trends, but is directly contrary to 30 years of congressional effort to achieve more uniform regulation of capital markets.

Mr. Wallison respectfully requests that this Honorable Court grant leave to file an *Amici* Brief in support of the Petition for a Writ of Certiorari.

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BRIEF *AMICI CURIAE* OF PETER J. WALLISON IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI OF AT&T CORP. AND GEORGESON SHAREHOLDER COMMUNICATIONS INC.

INTEREST OF *AMICI CURIAE*[1]

I am appearing in this action as a friend of the court because of my longstanding interest in regulatory policy, and especially securities policy. Between 1981 and 1985, I was general counsel of the Treasury, and took part in the Reagan administration's efforts to reduce the burden and uncertainty of financial services regulation. After a number of years as a partner of Gibson Dunn & Crutcher, practicing securities and banking law, I retired at the end of 1998 and joined the American Enterprise Institute as head of AEI's Financial Market Deregulation project. Since joining AEI, I have written extensively about securities regulation and the policies pursued by the Securities and Exchange Commission.

SUMMARY OF ARGUMENT

Twice during the mid-1990s, Congress attempted to limit the costly effect of securities class actions on public companies in the United States. In the Private Securities Litigation Reform Act of 1995 (PSLRA),[2] Congress sought

[1] Pursuant to Rule 37.6, *amici curiae* states that this brief was not authored, in whole or in part, by counsel to a party and that no monetary contribution to the preparation or submission of this brief was made by any person or entity other than the *amici curiae* or his counsel.

[2] Public Law 104-67, Dec. 22, 1995, 109 Stat. 737 (1995) (codified at 15 U.S.C. § 78u-4).

to place limitations on securities class actions. When the class action bar then resorted to state class actions, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (hereinafter "SLUSA")[3] to protect securities markets from this after-the-fact regulation by a patchwork of 50 different state laws. The key word in SLUSA is "uniform," as Congress continued a consistent effort – begun with the Securities Act Amendments of 1975[4] and continuing with the National Securities Market Improvement Act of 1996[5] and SLUSA – to create a uniform and national market for the sale and trading of securities.

The Seventh Circuit's excessively narrow interpretation of the SLUSA's scope contravenes the clearly expressed purposes of Congress, and will return the law to its condition before SLUSA's enactment.

Just in the last two months, two reports by respected groups have pointed to destructive class action litigation as a primary cause of the decline in major financial transactions and public securities offerings in the United States. These reports – a joint report by Senator Charles Schumer and Mayor Michael Bloomberg of New York,[6] and an Interim Report by a group of respected academics

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[3] Public Law 105-353 (November 3, 1998).

[4] Public Law 94-29, June 4, 1975; 89 Stat. 97 (1975) (originally codified at 15 U.S.C. § 78s(e)-(h)).

[5] Public Law 104-290, October 11, 1996, 110 Stat. 3424 (1996).

[6] M. Bloomberg and C. Schumer, *Sustaining New York's and the US' Global Financial Services Leadership* (available at http://www.nyc.gov/html/om/pdf/ny_report_final.pdf) (The "Bloomberg-Schumer Report").

headed by Glenn Hubbard and John Thornton[7] – have catalogued in detail the damaging effect of uncontrolled litigation on the willingness of foreign companies, and in some cases U.S. companies, to offer securities in the United States.

The Seventh Circuit's decision will make this problem measurably worse, by opening the courts of the fifty states to harassing class action litigation based on the many theories of liability offered by state consumer laws.

ARGUMENT

I. The Seventh Circuit's Decision Is Contrary to the Congressional Intent for Uniform Standards for Class Action Litigation

If we step back and look carefully at the securities laws adopted by Congress in the last 30 years, a clear pattern emerges. Unlike many other areas of the economy, Congress has consistently attempted to assure that a *national* securities market will develop – a market unimpaired and unrestricted by inconsistent state laws. The PSLRA and SLUSA are part of a string of enactments that show Congress taking action when it appeared that the securities market would become balkanized and inefficient, or when inconsistent state laws hindered the uniform administration of the securities laws.

[7] *Interim Report of the Committee on Capital Markets Regulation*. Available at http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf (The "Capital Markets Report").

This pattern of congressional concern began with the Securities Act Amendments of 1975, which directed the Commission to establish a "national market" in which investors everywhere in the United States would have access to securities trading facilities on equal terms.[8] This was followed by the adoption of 19(c)(1) of the Securities Act, which authorized the Commission to cooperate with state securities officials so as to "assist in effectuating greater uniformity in Federal-State securities matters."[9]

By 1995, it had become clear that a major threat to the development of a national securities market was the proliferation of class action litigation. In response, Congress enacted the PSLRA, which tightened the requirements for bringing and maintaining securities class actions under federal law.[10]

However, within only a few years, the class action bar developed ways to use the more lenient requirements of state law to continue the class action threat. Testimony before Congress showed that this move to state court had "damaged the overall efficiency of our capital markets."[11] Congress found that "maintaining differing federal and state standards of liability for nationally-traded securities" resulted in exposure to "significant liability that cannot easily be evaluated in advance, or assessed when a statement is made."[12] In response, Congress enacted the SLUSA

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[8] Public Law 94-29, June 4, 1975; 89 Stat. 97 (1975) (originally codified at 15 U.S.C. § 78s(e)-(h)).

[9] 15 U.S.C. § 77s(d).

[10] Public Law 104-67, Dec. 22, 1995, 109 Stat. 737 (1995) (codified at 15 U.S.C. § 78u-4).

[11] S. Rep. No. 105-182 at 3 (1998).

[12] *Id.* at 3.

to avoid "this fragmentation of investor remedies" in favor of "the benefits flowing to investors from a uniform national approach."[13]

The narrow scope of the SLUSA given by the Seventh Circuit's decision runs directly counter to the congressional intent in passing that act.

II. Securities Markets and U.S. Competitiveness Are Damaged by Frivolous Class Action Lawsuits, Coupled with the Uncertain Standards Created by a Patchwork Regulatory Structure

As noted in the Bloomberg-Schumer Report, excessive litigation has been particularly costly for public companies:

> The propensity toward litigation, a significant issue for society as a whole, is of particular importance to the securities industry, which in recent years has borne a disproportionate share of the overall cost. Not only did 2005 set a new record for the highest-ever number of securities class-action settlements, but the overall value of these settlements overshadowed every prior year. The total bill for securities settlements was $3.5 billion (omitting WorldCom-related settlements of approximately $6.2 billion), up more than 15 percent over 2004, and nearly 70 percent over 2003.[14]

The harm to American capital markets caused by excessive litigation expense and a patchwork of uncertain state law regulation of national transactions takes three

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[13] *Id.* at 3, SLUSA, Sec. 2(5).

[14] Bloomberg-Schumer Report at 74.

forms. First, capital is shifting to jurisdictions with lower costs and a less hazardous litigation environment. Second, companies avoid the excessive costs and risks of public ownership by buying out their public shareholders and "going private." Lastly, the free flow of information to investors is deterred by the risk that any statement by a company manager can be found "fraudulent" or "misleading" in an ex post evaluation under uncertain state law.

A. Outsourcing America's Capital Markets

Capital has no natural home, and can easily shift to jurisdictions with rules allowing efficient transactions. Where companies have a choice about where they will raise capital, they will avoid the litigation risks that currently exist in the United States.

Even before the Seventh Circuit's decision, the wild and woolly litigation environment of the United States was chasing public offerings of securities overseas. This flight of capital from America to jurisdictions with more predictable litigation environments is well documented. Between 1996 and 2001, the New York Stock Exchange averaged fifty new non-U.S. listings annually; in 2005, it gained nineteen. In the same year, the London Stock Exchange, including its small-company affiliate, the Alternative Investment Market, gained 139 new listings. NASDAQ in 2005 gained only nineteen.

This trend was highlighted only last month in the comprehensive Bloomberg-Schumer Report. The Report notes that America's leadership in world financial markets is threatened, among other things, by the willingness of companies seeking to raise capital to do so in foreign markets:

> When looking at all IPOs [initial public offerings] that took place globally, the share of IPO volume attracted by US exchanges in 2006 is barely one-third of that captured in 2001. By contrast, the global share of IPO volume captured by European exchanges has expanded by more than 30 percent over the same period, while non-Japan Asian markets have doubled their equivalent market share since 2001.[15]

This shift was most pronounced in the larger scale IPOs, as U.S. exchanges captured 57 percent of IPOs over one billion dollars in 2001, compared to only 16 percent in 2006.[16]

The loss is not just limited to foreign companies. London's Alternative Investment Market has even attracted 35 American companies. London's ability to compete with America as a marketplace for capital is particularly remarkable, given that England's economy is only a fraction of our own. However, the United Kingdom offers something that this country does not, a stable and predictable legal system which does not permit class action litigation.

While the Bloomberg-Schumer Report identifies many culprits in this flight of capital, one key aspect was the costs of responding to litigation:

> When asked which aspect of the legal system most significantly affected the business environment, senior executives [on both sides of the Atlantic] surveyed indicated that the propensity

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[15] Bloomberg-Schumer Report, pg. 43.

[16] *Id.* at 43.

> toward legal action was the predominant problem. Worryingly for New York, the city fares far worse than London in this regard: 63 percent of respondents thought the UK (and by extension London) had a less litigious culture than the United States, while only 17 percent felt the US (and by extension New York) was a less litigious place than the United Kingdom.[17]

According to the Report, 85 percent of CEOs surveyed indicated that they preferred the legal environment in London, and not one stated that he or she preferred New York.[18]

A virtually identical pattern was found by the Interim Report of the Committee on Capital Markets Regulation. This Committee, composed of a widely representative group of respected academics headed by Glenn Hubbard (Dean of the Columbia Business School and former chair of the President's Council of Economic Advisers) and John Thornton (chair of the Brookings Institution), concluded that:

> Clearly, the threat of private liability is something any public company must take seriously. While much is in dispute about securities class action litigation, the prevalence of lawsuits, the enormous size of their settlement values, and the large burden they impose on companies and their shareholders are not.[19]

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[17] *Id.* at 75.

[18] *Id.* at 75.

[19] Committee on Capital Markets Regulation, *Interim Report*, p. 74.

B. Leaving the Field

Other companies avoid the onerous regulation of America's capital market by choosing other means of raising capital, generally private equity. The once-significant advantages of public ownership have been eroded by the reporting costs, regulations, and litigation risks associated with having public shareholders. The Government Accountability Office (GAO) found that the number of public companies going private increased from 143 in 2001 to 245 in 2004, and projected that the number would reach approximately 267 by the end of 2005. "The costs associated with public company status were most often cited as a reason for going private," said the GAO.[20]

And it isn't just the smaller companies, private equity firms are taking some of America's largest corporations private:

> At the same time that some companies may be looking to go private to avoid regulation, private equity firms are on an acquisition tear. In recent years, private equity firms have taken many previously-public companies private, including well-known names such as Hertz, Neiman Marcus, Metro-Goldwyn-Mayer, and Toys 'R' Us. These deals totaled more than $22 billion.[21]

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[20] United States Government Accountability Office, Sarbanes-Oxley Act: Consideration of Key Principles Needed in Addressing Implementation for Smaller Companies (GAO report to the U.S. Senate Committee, on Small Business and Entrepreneurship, Washington, D.C., April 2006), 21-22.

[21] Morrow, Matt, *The SOX Appeal of Going Private*, Business Week, Nov. 29, 2005.

It is significant that companies fleeing the public capital markets aren't doing so to avoid scrutiny or to engage in accounting dodges. Many of the owners are playing with their own capital, the others are dealing with sophisticated private equity managers. Rather, these are businesses for whom the costs and the risks of the public capital markets have simply become too high.

Companies fleeing public equity markets because of excessive regulation or fear of litigation work a concrete harm on the markets. They reduce the options available to the investing public. And it hardly helps the larger economy and the cause of economic growth when companies forego the most efficient method of raising funds.

C. Muffling the Free Flow of Information

The central premise of the securities market is that investors are capable of making their own investment decisions. The cornerstone of this central premise is the free flow of information about publicly listed companies to the investing public.

In this, the market has been wildly successful. In his influential book, *A Random Walk Down Wall Street*, Professor Burton Malkiel notes that information about public companies is well disseminated and assimilated into stock prices. "Prices adjust so well to reflect important information that a randomly selected and passively managed portfolio of stocks performs as well or better than portfolios selected by experts."[22] In other words, an investor

[22] Burton G. Malkiel, *A Random Walk Down Wall Street*, W.W. Norton, 1999, p. 268.

can often match the performance of the professional manager of a mutual fund by throwing darts at a financial page.

The efficiency of the stock markets in assimilating information depends – of course – on this information being freely available. But, as Congress found, securities litigation was limiting the willingness of CEOs and financial managers to make predictions about their companies' performance.

> Fear that inaccurate projections will trigger the filing of a securities fraud lawsuit has muzzled corporate management. One study found that over two-thirds of venture capital firms were reluctant to discuss their performance with analysts or the public because of the threat of litigation.[23]

As to mandated disclosures, fear of litigation was resulting in the employment of "legions of lawyers [to] scrub required filings to ensure that disclosures are as milquetoast as possible, so as to provide no grist for the litigation mill."[24]

In enacting the PSLRA Congress addressed this problem by including a "safe harbor" provision allowing immunity for clearly identified forward looking statements.[25] Of course, it will do corporate managers little good (as well as frustrate the congressional intent) if plaintiffs' attorneys can avoid the safe harbor by reference

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[23] S. Rep. No. 104-98 at 16 (1995).

[24] *Id.*

[25] 15 U.S.C. § 78u-5.

to state law class actions. This is precisely what is at risk if the Seventh Circuit's decision is allowed to stand.

III. CONCLUSION

The Seventh Circuit's decision gives new life to the patchwork of state consumer laws that, combined with lenient state class action rules, can be used by the class action bar to evade Congress' efforts over 30 years to create a uniform national securities market in the United States. In the last two months, the harm that excessive litigation has done to the U.S. economy and the pre-eminence of the United States as a financial center has been catalogued by two major reports by highly respected groups. If allowed to stand by this Court, the Seventh Circuit's decision will undo the effort of Congress – in SLUSA and other major legislation over 30 years – to stem the tide of destructive class action litigation in the United States.

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